IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	**)**	
	)	
LAKE CITY R.V., INC.,	**)**	**Case No. 95-03264**
	)	
	)	**MEMORANDUM OF DECISION**
Debtor.	**)**	**AND ORDER**
	)	
_____	**)**	

H. James Magnuson, Coeur d'Alene, Idaho, for Trustee.

Malcolm S. Dymkoski, Coeur d'Alene, Idaho, for John and Jacquelyn Gale.

David L. Erickson, Couer d'Alene, Idaho, pro se.

The Trustee previously sued John and Jacquelyn Gale for recovery under § 547(b) of the Code, recovering judgment in the amount of $105,435.16 in March 1999. The Trustee has moved the Court, pursuant to Rule 9019, to approve a compromise between the Trustee and the Gales under which Gales will pay the estate $59,685.60. Notice was given to all creditors, as required by Rule 2002(a)(3).

Only one creditor, David Erickson, has raised objection to the proposed compromise. This was done through a "letter" to the Court which though improper in form was filed as a pleading in the case file at the direction of the Court. Mr. Erickson also appeared at the scheduled hearing on the Trustee's motion to voice his concerns. The Motion was taken under advisement at the close of the hearing, subject to further submissions by the proponents of the compromise, which submissions have now been made. The following constitutes my findings and conclusions on the Motion. Rules 9014, 7052.

BACKGROUND

Lake City operated a recreational vehicle dealership before filing bankruptcy. The Gales were found, in an adversary proceeding brought by the Trustee under § 547 of the Code, to be unsecured creditors of Lake City. *Elsaesser v. Gale (In re Lake City R.V., Inc.)*, 99.2 I.B.C.R. 51 (Bankr. D.Idaho 1999). Thus, when the Gales received payments and exercised rights under certain documents, they received preferences rather than recoveries on allegedly secured claims. *Id.*

Judgment was entered on March 29, 1999, in the amount of $105,432.16. This amount was composed of (a) payments of "interest" made by Lake City to Gales of $2,159.57; (b) transfer to Gales of $ 24,213.09 from a "dealer savings account"; and (c) the Gales' recovery of vehicles with a value of $79,062.50. *See*

99.2 I.B.C.R. at 54, n.10. The Trustee's form of judgment expressly provided for accrual of post-judgment interest at the "applicable statutory rate."[1]

The Trustee's Motion seeks to compromise the Gales' liability for $59,685.60. This, the Trustee asserts, is the difference between the judgment amount[2] and the approximate dividend the Gales would receive as creditors of the estate if they paid the entire judgment and asserted a claim under § 502(h).[3]

A claim was filed on May 18 by the Gales, asserting an unsecured claim against the estate for an amount equal to the principal amount of the judgment. However, this judgment amount has yet to be paid, and thus no allowable § 502(h) claim has arisen. See § 502(d) and the discussion, *infra*.

The Trustee's motion refers to a "transcript" of certain "proceedings" dated May 20, 1999, as further explaining this settlement. A copy of this transcript was not submitted to the Court with the Motion, but was apparently freely provided to creditors on request. A copy was attached to Mr. Erickson's letter.[4] The same reflects an agreement in principle reached by the Trustee and the Gales

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[1] This would necessarily be the rate(s) established by 28 U.S.C. § 1961.

[2] The compromise addresses collection on the outstanding judgment. Yet the Trustee nowhere identifies the actual outstanding judgment amount with interest.

[3] Section 502(h) provides that a claim arising from the recovery of property under, inter alia, § 550 shall be determined and allowed under § 502(a) through (e) as if such claim had arisen before the date of the filing of the petition.

[4] A copy was also attached to the Trustee's post-hearing memorandum in support of the Motion.

at the time set for a "debtor's examination" of Mr. Gale by the Trustee in furtherance of collection.[5]

That transcript reflects that the concept of the agreement was as follows. The Trustee would estimate what distribution would be made to the Gales in the event they paid the judgment and thus became entitled to a unsecured claim in that amount. The Trustee would do this by estimating all available assets, including the "recovery" of $105,000 from the Gales, and calculating a projected dividend to unsecured creditors from the net assets remaining after payment of priority claims and administrative expenses. The Gales' potential §502(h) claim was included in the pool of unsecured claims for purposes of this calculation. The Trustee agreed to provide to the Gales a figure reflecting the anticipated distribution to the Gales under this scenario, and the Gales agreed to pay the difference between this amount and $105,000, and waive all claims against the estate. Thus the effective "net" amount of the judgment, which would otherwise be recovered by the estate for the benefit of all creditors other than the Gales, would be obtained.

Documents reflecting the calculations of the Trustee in reaching the settlement figure of $59,685.60 were not initially provided to the Court in support of the Motion. However, Mr. Erickson's "objection" enclosed a copy of a

[5] Certain sums had already been seized from a bank account of the Defendants.

May 27 letter from the Trustee's counsel to the Gales' counsel which appears to set forth the calculations.[6] This analysis assumes an asset pool composed of a $105,000 recovery from the Gales in addition to some $33,000 already held by the Trustee. It assumes $20,800 in administrative expenses and approximately $17,000 in priority unsecured claims. It calculates the probable distribution to unsecured creditors based on $130,248.36 in filed, allowable unsecured claims plus a $105,000 claim for the Gales, apparently in contemplation of § 502(h). This would, according to the Trustee, result in a 43% distribution to the unsecured creditors. The difference between the distribution which would assumedly go to the Gales, and the full amount of the Judgment, is pegged at $59,850.

The objection to this compromise by Mr. Erickson[7] raises several issues:

1. Whether the Gales' claim filed on May 18, 1999 was timely and/or valid.

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[6] This information is mirrored by the explanation of the calculations appearing in the Trustee's post-hearing brief.

[7] Mr. Erickson is no stranger to these proceedings, or to the Trustee. He was the unsuccessful plaintiff in earlier adversary litigation in the bankruptcy case of Lake City's principals. *Elsaesser v. Foster, et al*, Adv. Nos. 96-6057, 96-6058. He was also the objector to the Trustee's pre-trial proposed compromise of the instant litigation for $14,527.85, which the Court disapproved by decision entered October 23, 1998. *In re Lake City R.V., Inc.*, 98.4 I.B.C.R. 104 (Bankr. D.Idaho 1998).

2. Whether settlement by reference to this claim gives the Gales a "prepayment" of their claim.

3. Whether the Gales have unfairly had the use of the Debtor's funds for an extended period (termed "investment income" by Mr. Erickson), and whether this should be captured by the estate as prejudgment interest on the adversary judgment.

4. Whether the Trustee's calculation of the prospective dividends was accurate, in large part due to the alleged omission in those calculations of the "unsecured" claims of the Erickson.[8]

The Court concludes that certain of these objections are well taken, and that the Motion of the Trustee should be denied.

APPLICABLE LAW

As set forth in last October's decision, concerning the earlier proposed settlement between these same two parties, the Court may approve a compromise only if it is fair and equitable, and this determination requires that an adequate factual and legal basis be established by the proponents. 98.4 I.B.C.R. at 105,

[8] Mr. Erickson previously filed secured claims in this case. Mr. Erickson amended his claims to "unsecured" in September 1999, after the Trustee's deal with the Gales had been struck. The Trustee did not include the amounts of these claims, which were sizeable, in calculating the probable distributions on unsecured claims and, thus, the settlement figure.

discussing *Martin v. Kane (In re A&C Properties)*, 784 F.2d 1377, 1382-83 (9th Cir. 1985); *In re Pintlar/In re Gulf USA Corp.*, 94 I.B.C.R. 76, 77 (Bankr. D.Idaho 1994). The Court must consider several factors before acceding to the Trustee's business judgment and approving a settlement. The Trustee, as the party proposing the compromise, has the burden of creating a sufficient record, establishing all objective elements necessary to adequately inform the Court,[9] and ultimately bears the burden of persuasion.

DISCUSSION

The notice provided to creditors alludes to the methodology underlying the compromise, though creditors and the Court have had to ask for the specifics.

From the information provided by the objector, and by the Trustee at hearing and following hearing, the Court understands that the key to the Motion, and indeed to the deal struck, is to calculate the net result of (i) full payment of the judgment, and (ii) distribution to creditors, including the Gales. The parties recognize that, upon full payment of the judgment, the Gales will be entitled to

[9] It's difficult to understand why the settlement was not better explained and the Trustee's contentions more completely set forth, particularly in light of the October 1998 decision, which addressed in some detail the problems encountered with incompletely explained compromises, as well as articulated the authorities governing the Court's consideration of such proposals. The affidavit of the Trustee filed prior to hearing was rather conclusory. While it discussed the motivation for settlement, it did not address the specifics of the settlement proposal or provide detail upon which the reasonableness of the compromise could be evaluated. Only in his post-hearing memorandum did the Trustee more completely explain his position and the basis for the settlement proposal.

an unsecured claim in that amount. § 502(h). The Gales wish, reasonably enough, to avoid paying the full amount of the settlement only to have, in a few month's time, a significant portion of that payment returned to them by the Trustee as a dividend on an allowable § 502(h) claim. The Trustee wishes to avoid this scenario since he is more likely to succeed in getting $60,000 from the Gales than $105,000.[10]

With this general methodology and proposed settlement, the Court has no real objection. The devil, as usual, is in the details.

A. Predicting the distribution

First, and foremost, the calculations used by the Trustee must be defensible. Here, the objector has raised an issue as to the math, particularly with the amount of the total pool of unsecured creditors, and the Court must agree with that objection.

The function of the calculation, under the theme of the settlement, is to accurately forecast what unsecured creditors will receive. The farther removed in time from the actual final accounting, the more suspect the calculation. Claims may generally be amended unless doing so results in prejudice to another party or the estate, or the amendment actually asserts a new, time-barred claim. *See*

[10] Briefing indicates that the Trustee has possession of the full settlement amount pending Court approval of compromise.

generally, *In re Roberts Farms Inc.*, 980 F.2d 1248, 1251-52 (9th Cir. 1992); *In re Wilson*, 96 B.R. 257, 261-62 (9th Cir. BAP 1988).

The amendments of Mr. Erickson here simply change the classification of two asserted claims from secured to unsecured. He could clearly have amended at a date far earlier than he did, but the Court can't lay the blame for the mistaken calculations at the creditor's feet, even though he did amend after the settlement was reached by the Gales and the Trustee.

One of the claims is allegedly secured by the stock of Lake City. The Trustee is clearly in a position to tell whether there is any value to this alleged security. Even his own calculations indicate only a pro rata dividend to Lake City's unsecured creditors. The second and larger claim concerned Ericksons' financing of the debtor, and the existence of security for these claims was an integral part of the dischargeability litigation of the Ericksons against the Fosters. The Trustee here obviously knew that Judge Hagan had determined that these claims of the Ericksons were unsecured rather than secured. The Trustee argued at length, during the Gales' litigation, about the similarities between the Gales' lack of valid security and Judge Hagan's findings on that same score regarding the Ericksons, and even briefed the *Erickson v. Foster* decision in the context of both summary judgment and the first proposed compromise in 1998.

The Trustee hasn't argued that some part or all of either of these claims should be disallowed entirely. The Trustee had ample information upon which to conclude that the two "secured" Erickson claims would ultimately be treated in this case as unsecured claims.

Not including these claims in his analysis of likely distributions appears simply to be an oversight. Nevertheless, by reason of the omission of some $93,000 in claims from the Trustee's calculations, it appears the distributive analysis which underlies the compromise is flawed.[11] Therefore, under the theory of settlement proffered by the Trustee, the settlement amount is unsupported. The objection of Mr. Erickson on this ground will be sustained.

B. The § 502(h) claim

The next major dispute of Mr. Erickson has to do with the timing and validity of the Gales' May 18 claim filed, presumptively, under § 502(h). Though the claim bar date has long since expired, that is not a basis upon which to disallow a claim under §502(h). The real problem here is found in that portion of § 502(d) which provides that a claim arising upon recovery from a creditor is not allowable until that creditor has paid the amount or turned over the subject property. The Gales have not paid the judgment and their claim under §502(h) is

[11] The Court also notes that the calculations don't address the post-judgment interest awarded on the Gale judgment.

not allowable until they do. Mr. Erickson's contention is therefore technically correct.

However, this does not necessarily foreclose the ability of the Trustee to enter into a settlement premised upon (a) the assumption that the entire judgment will be paid or recovered upon, (b) the allowance at that time of a proper § 502(h) claim, (c) the effect of that recovery on the asset pool, and the effect of that § 502(h) claim on the unsecured creditor pool, and (d) calculation, prospectively, of the pro rata dividend to unsecured creditors based on all those assumptions.

While Mr. Erickson is correct that the Gales' claims are not yet valid, his objection doesn't prohibit the type of settlement structured by the parties. That objection will be overruled.

C. Prejudgment interest

Mr. Erickson also raises issues as to whether the judgment against the Gales should include a recovery of the "benefit" the Gales received for their use and possession of the Debtor's funds until the date of judgment. For lack of a more embraceable concept, the Court will characterize this as a question of "prejudgment interest" on the preference recovery.

There are several problems with this particular objection. First, Mr. Erickson is a stranger to the adversary litigation between the Trustee and the

Gales. He has no standing in this suit, whether to demand prejudgment interest or otherwise. Second, this is not a proposed settlement of the underlying litigation, where a creditor might assert that the Trustee is letting the defendants off too cheaply because prejudgment interest is not taken into consideration. Here, the cause was litigated and the Trustee awarded summary judgment. The Trustee did not pray for prejudgment interest, and none was awarded. Third, Mr. Erickson has provided no authority as to the allowance of prejudgment interest on preferences.

The question presented by the instant Motion is how the Trustee is to collect on the judgment he received, not what higher judgment he might have received.

On this record, and in light of the finality of the underlying judgment, the Court concludes that this is not the proper time or context to undertake consideration of the issue of prejudgment interest. The objection on this ground will be overruled.

CONCLUSION

The proposed settlement cannot be approved at this time under the authorities guiding this Court in such matters. The Trustee has failed to provide an adequate record explaining and defending his proposal, and has failed to carry the burden of persuasion imposed by the case law.

The primary difficulty with the proposed compromise is not its philosophical structure or methodology, but its math. The proposal, as best the Court can divine, seeks to come up with a number which assumes payment in full of the judgment and allowance of distribution back to the judgment debtors on a § 502(h) claim.

But the calculations proffered in support of the settlement do not include or account for (a) post-judgment interest or (b) an accurate amount of all allowable or probably allowable unsecured claims. Thus, the Trustee's settlement amount is not consistent with his announced approach to compromise and appears to understate the net recovery to the estate.

The Court cannot simply undertake to do the math itself, and arrive at a compromise amount based on a revised distribution analysis. First, the Court is limited to approving or disapproving the compromise tendered by the parties. Moreover, there is nothing in this record that indicates that the Gales would enter into a compromise if the settlement amount were increased.

The Court however can provide the litigants a chance to propose a settlement which both follows their announced theoretical approach and addresses the present infirmities in calculation. Alternatively, the Trustee can renew the present Motion, and attempt to persuade the Court on an improved record that the settlement is sound and well justified (notwithstanding the math)

and should be approved. Perhaps there is some other settlement which can be properly supported and approved. And, of course, the Trustee has the alternative of continuing his collection activities on the judgment. For these reasons, the denial of the Motion will specifically be without prejudice to further proceedings.

ORDER

For the foregoing reasons, the Motion is DENIED, without prejudice.

Dated this 29th day of September, 1999.

TERRY L. MYERS
UNITED STATES BANKRUPTCY JUDGE